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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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A Weaker Dollar . . .

As with the first quarter's gross national product (GNP) number, last week's government report on business activity in the second quarter may mask more than it reveals. According to the Commerce Department, the nation's inflation-adjusted GNP expanded at an anemic 1.7 percent seasonally adjusted annual rate over the last quarter, well below the Department's initial "flash" estimate of three percent GNP growth. But before hunkering down in anticipation of another recession, a look beneath the surface of the top-line GNP number reveals an economy actually much stronger than it seems. For once the effects of diminished inventory spending by business and the widening trade deficit are removed from the GNP statistics, the pace of economic growth vaults from the reported 1.7 percent to more than six percent. With hefty levels of consumer spending leading the way, real final domestic demand (real GNP minus net exports and the change in inventories) advanced at a 6.3 percent annual rate in the second quarter—nearly twice the pace of the first.

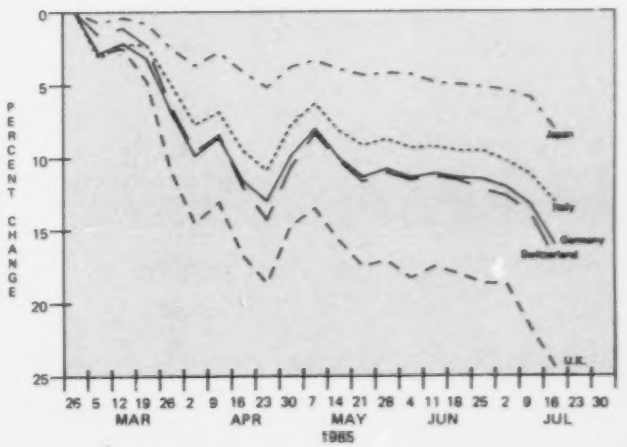
The drag on growth stemming from both diminished inventory spending and a widening trade deficit contains both pluses and minuses. On the plus side, the modest pace of inventory accumulation, as well as the lean levels existing economy-wide, suggest that any further upturn in final demand could be quickly translated into stepped-up manufacturing activity domestically. Unless, of course, such demand is largely satisfied by goods from abroad—producing, on the minus side, an even larger trade deficit. However, the recent retreat of the dollar in the foreign exchange markets may forestall such a development, promising some long-awaited relief for the hard-pressed manufacturing sector.

After reaching record highs at the end of February, the dollar's external value has dropped by more than 15 percent on a trade-weighted basis. It has depreciated substantially against the major currencies—by 24 percent against the pound sterling, by 16 percent against the German mark and by eight percent against the Japanese yen (see chart). As a result, by last week the dollar had reached a 12-month low against several of these currencies.

. . . Raises The Possibility . . .

While in the past the dollar might have soon recovered and moved on to even loftier heights, this time around such a development appears unlikely. One reason for this is the sharp descent of domestic interest rates in recent months, and the narrowing of yield differentials between here and abroad. For whereas relatively high U.S. interest rates gave the dollar great support in the past, this foundation has become more tenuous. In the past 12 months, U.S. short-term rates have fallen by 4½ percentage points, while Japanese rates held steady, German rates fell by half a point and U.K. rates actually rose three percentage points. When inflation-adjusted interest rates are examined, a similar pattern of diminished support for the U.S. dollar, and enhanced appeal for key foreign currencies emerges.

DEPRECIATION OF U.S. DOLLAR
VS. SELECTED FOREIGN CURRENCIES
(PERCENT CHANGE FROM FEBRUARY 26, 1985)



The Congressional testimony of Federal Reserve Chairman Volcker last week also points to a further decline in the value of the dollar. What the Fed clearly desires is to promote a more rapid business expansion in the second half of this year. By permitting faster growth of the U.S. money supply, the Fed could well produce a further decline in interest rates before they head higher. The vehicle that the

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Fed intends to use appears to be a weaker dollar, for it has become clear that the strong dollar has been the key factor that has inhibited U.S. economic growth in recent months.

The Fed's policy of encouraging a lower dollar is probably the only step feasible at this time. Although this may prove to be inflationary sometime down the road, in the short-term, inflation should not be a problem because of large amounts of unused factory capacity, a relatively high level of unemployment and strong competition from abroad. If the Fed can inject greater vigor into the U.S. manufacturing sector by enabling it to compete in international markets, this might alleviate a number of problems that have cropped up in recent months including falling manufacturing employment and contracting U.S. exports.

A falling dollar would also have a number of repercussions overseas. Economic growth abroad might be dampened somewhat as companies find it harder to compete with U.S. firms. But this might be offset by the positive impact of falling interest rates abroad as governments loosened their monetary policies, recognizing that this step would not make their currencies depreciate against the dollar as in the past.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit	7/17/85		
U.S. Gov'ts and Agencies Owned Outright & RPs	179.404	+ 1.233	+16.808
Loans to Depository Inst.	1.171	– .225	– 4.720
Float	.614	– .172	– .099
Total Reserve Bank Credit	193.539	+ .957	+15.594
Treasury Deposits with Federal Reserve Banks	3.219	– 1.325	– .196
Currency in Circulation	188.057	– .636	+11.229
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	124.254	+ .010	+ 8.632
	7/17/85		
Member Bank Reserves:			
Total Reserves Held	42.889	+ .665	+ 4.488
Excess (Deficiency)	.598	– .583	+ .146
Net Borrowed Reserves	.203	+ .837	+ .089
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates†			
M1 (7/8/85)	596.2	+ 14.3‡	+ 8.5‡
M2 (June '85)	2,472.8	+ 7.2	+ 9.0
M3 (June '85)	3,103.3	+ 6.3	+ 9.3
Domestic Nonfinancial Debt (1st Q'85)	6,147.0	+ 11.3	+ 13.6

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/19/85	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.17%	7.28%	7.37%
* Federal Agencies	7.14	7.38	8.03
* Municipal Notes—High Grade (46% Taxable Equivalent)	7.41	7.87	8.15
Negotiable Time CDs Manufacturers Hanover		Rates By Arrangement	
* Secondary Market—Prime	7.65	7.80	8.25

‡ Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.60%	Aug.	7.65%
15- 29 days	7.60	Sep.	7.65
30- 59 days	7.60	Oct.	7.65
60- 89 days	7.60	Nov.	7.65
90-179 days	7.65	Dec.	7.65
180-239 days	7.65	Jan.	7.65
240-270 days	7.65		

‡ Industrial Paper—Prime		† Federal Funds	
30- 89 days	7.55%	Effective Rate	7.88%
90-120 days	7.45		

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'85n	$ 3,854	$ 3,811	$ 3,645
Gross National Product (1972 Dollars)*	2nd Q'85n	$ 1,671	$ 1,664	$ 1,639
Percent Change, Annual Rate	2nd Q'85n	1.7	0.3	7.1
Change in Consumer Prices*	May '85	2.4%	4.8%	2.4%
Change in Producer Prices*	Jun '85n	0.0%	2.4%	0.0%
Civilian Employment (Thousands of Persons)†	Jun '85	106,370	106,960	105,391
Unemployment as % of Civilian Labor Force†	Jun '85	7.3%	7.3%	7.2%
Personal Income*	Jun '85n	$ 3,187	$ 3,170r	$ 3,007
Leading Indicators Composite Index (1967=100)†	May '85	167.8	166.6	168.2
Industrial Production Index (1977=100) † **	Jun '85n	124.6	124.4r	122.3r
Net Change in Consumer Installment Credit †	May '85n	$ 9.04	$ 8.27	$ 9.09
U.S. Merchandise Trade Balance †	May '85	–$ 12.67	–$ 11.85	–$ 9.28
Plant and Equipment Expenditures*	3rd Q'85	$392.61(a)	$385.31(a)	$361.12
Private Housing Starts (Thousands of Units)*	Jun '85n	1,705	1,673r	1,837
New Construction Expenditures*	May '85	$ 343.5	$ 338.3	$ 315.7
Total Business Inventories †	May '85n	$ 577.9	$ 580.2r	$ 550.5
Total Business Sales †	May '85n	$ 427.6	$ 426.7r	$ 412.5

*Seasonally adjusted annual rate. †Seasonally adjusted.
**Rebased to 1977=100 from 1967=100.

n-Newly reported figure. r-Revised. a-Anticipated.

. . . Of Stronger GNP Growth

The developing countries would also benefit in more ways than one from the above developments. If the weaker dollar were associated with a general drop in interest rates everywhere, their debt service burden would become lighter. Prices of their commodity exports, which have been dampened by high interest rates and the strong dollar, may also rise. That would, of course, bring in more revenues and could also stimulate additional spending on exports from the industrial countries. What is more, the cost of developing country imports which are priced in dollars—most importantly petroleum—would also become cheaper as the dollar declines, if they are paid for with earnings from non-dollar currency countries.

All these potentially beneficial consequences would, however, not come about if the dollar did not weaken in an orderly fashion alongside a gradual decline in U.S. interest rates. "Hard landing" theorists argue that the dollar could instead crash if global holders of dollars lose confidence in U.S. monetary management and sell the currency. This process would probably be associated with a scramble to get out of U.S. financial assets in general, leading to rising, rather than falling, U.S. interest rates. This could produce a recession in the U.S., rather than the economic growth that the Fed desires. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (7/3/85)	154,092	– 339	– 2,662
New York City (7/10/85)	32,327	– 488	– 2,298
Commercial Paper (7/10/85)	263,695	+ 1,958	+39,789

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/3/85)	254,213	+ 1,935	+ 7,970
New York City (7/10/85)	60,305	– 602	– 3,973

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/3/85)	685,647	+ 6,322	+ 61,075
New York City (7/10/85)	150,055	– 3,201	+ 11,947

Financial Markets

	Friday 7/19/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.38%	+ .08	– 3.15
180-Day Bills†	7.62	+ .06	– 3.62
Longest Bills†	7.88	+ .01	– 4.06
Recent Issues:			
8 1/2s 6/30/87	8.78	+ .04	
9 5/8s 6/30/89	9.53	+ .06	
11 1/4s 5/15/95	10.32	+ .08	
11 1/4s 2/15/15	10.51	+ .07	
Municipals:			
Bond Buyer–20 Bond Index* (7/18/85)	8.73%	– .08	– 1.63
Blue List Total ($ Million)	$1,818	– $103	+ $ 685
30-Day Visible Supply ($ Million)	$3,453	+ $503	+ $1,619
Total	$5,271	+ $400	+ $2,304
Corporates:			
Moody's Aa Composite (7/18/85)	11.36%	– .01	– 2.76
30-Day Visible Supply ($ Million)	$3,353	– $202	+ $2,953
Stocks:			
Dow-Jones Averages:			
Industrials	1,359.54	+ 20.94	+ 258.17
Transportation	700.73	+ 12.76	+ 248.98
Utilities	166.24	– 2.67	+ 42.54
65 Stocks	566.08	+ 6.47	+ 139.68
Standard and Poor's 500 Stocks	195.13	+ 1.84	+ 45.58
N.Y.S.E. Composite Index	113.29	+ 1.16	+ 27.08
N.Y.S.E. Avg. Daily Vol. for Week (000's)	128,642	+21,850	+ 48,994

* 46% Taxable equivalent 16.17%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/19/85	Week Ago
Overnight	7.75%	7.69%
1 month	7.81	7.75
3 month	7.94	7.88
6 month	8.13	8.00
1 year	8.50	8.44
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	10.40%	10.10%
Long Term (7 to 15 yrs.)	10.90	10.65

FOREIGN EXCHANGE SPOT RATES

New York Opening (7/19/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01733	57.7000
Canada	.7433	1.3453
Denmark	.09695	10.3150
France	.1149	8.7050
Germany	.3484	2.8700
Italy	.0005342	1872.00
Japan	.004205	237.83
Mexico	.002706	369.50
Netherlands	.3097	3.2290
Switzerland	.4228	2.3650
U.K.	1.4035	.7125

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